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TAGS: OREP AMGT ASEC AFIN ECON ETRD CS
SUBJECT: SCENESETTER: CODEL BLUNT IN COSTA RICA

REF: SECSTATE 220612

Classified By: Ambassador Mark Langdale for Reasons 1.4 (b) and (d)

¶1. (U) SUMMARY: Embassy San Jose warmly welcomes CODEL Blunt on its December 19) 20 visit to Costa Rica. The delegation's visit comes at a time when the main issue in the bilateral relationship is the Central America-Dominican Republic-United States Free Trade Agreement (CAFTA-DR). The debate has just started in the Costa Rican unicameral 57-member legislature (the Assembly), and the entire ratification process will take at least six months due to the required legislative process and the elections on February 5, 2006 of a new President and new Assembly members (deputies). (Note: The Costa Rican Constitution does not allow elected officials to serve consecutive terms. End Note.) End Summary.

COSTA RICA) A LONG HISTORY OF DEMOCRACY

¶2. (SBU) Costa Rica has a strong history of democracy and of making decisions by consensus. In 1948, after a brief civil war, the army was abolished to preclude military interference in the country's politics and to allow a greater concentration of resources for universal health care, education, and a relatively generous social welfare system. The consensus-building aspect of democracy in Costa Rica results in slow decision-making but has allowed Costa Rica to avoid the civil wars that wracked its Central American neighbors in the latter half of the twentieth century. As a result, Costa Rica is the most developed country in Central America with the lowest poverty and unemployment rates, lowest infant mortality rates, and highest GDP per capita.

¶3. (SBU) To spur development in the middle of the last century, the legislature created state-owned monopolies in the banking, electricity, telecommunications, petroleum distribution, and insurance markets. Income from these institutions was used to help the poor and ensure services reached all corners of the country. But over the years these institutions have become large, bloated, and inefficient entities that deliver poor quality services and are susceptible to corruption. Despite these faults, many Costa Ricans continue to view these organizations as venerable institutions that demonstrate that the state will continue to take care of them.

¶4. (SBU) The current President, Abel Pacheco (Louisiana State University-educated psychiatrist), was elected in the country's first-ever run-off election in April 2002 in which he won 58 percent of the vote. President Pacheco is in his final months as President, and he has seen his popularity rating drop during the course of his administration. This is due in part to his accepting gifts and favors which violated the same anti-corruption laws that he championed, but is principally due to a generally-held low opinion of his effectiveness as president. President Pacheco has seen 18 cabinet-level ministers resign, some over the President's uneven and wavering support for CAFTA-DR. Most of the management of the Ministry of Foreign Trade (COMEX) that was responsible for negotiating and implementing the agreement left the organization over the last 18 months.

STATE OF RELATIONS WITH GOCR

¶5. (C) Relations between the United States and Costa Rica are friendly, abiding, and complex. We share core political values, including a belief in democracy and a commitment to human rights. Like the United States, Costa Rica does not have formal diplomatic relations with Cuba and is concerned about attempts by the Venezuelan government to increase its influence in the hemisphere. Although Costa Rica has no military, the Costa Rican Coast Guard and police cooperate closely with the U.S. Coast Guard, Navy, and Drug Enforcement Agency (DEA) in narcotics interdiction. In August 2004, President Pacheco signed the seven-nation Central

America-Dominican Republic-U.S. Free Trade Agreement (CAFTA-DR) but, because of his inordinate fear of protests by public sector unions and university students, he waited until October 2005 after every other potential partner had already ratified the treaty before submitting it to the legislature to begin the lengthy process of ratification. As a result, Costa Rica will likely be the last country to join CAFTA-DR. On December 7 Peru and the U.S. finished negotiations on a free trade agreement.

¶6. (C) U.S. economic assistance to Costa Rica has fallen dramatically since 1995 when we closed our bilateral USAID mission. There was an upsurge in U.S. military and counternarcotics assistance with the signing of a Bilateral Maritime Agreement in 1998, but that assistance has now been reduced very substantially because of Costa Rica's unwillingness to sign an Article 98 agreement (committing Costa Rica not to surrender U.S. nationals to the International Criminal Court) and a shift in priorities in the State Department's Bureau of International Narcotics and Law Enforcement Affairs (INL). Failure to sign an Article 98 agreement also has caused Costa Rica to be ineligible for trade capacity-building funds to implement CAFTA-DR. This decline in assistance, which is viewed as "sanctions" by many in the GOCR and the press, unavoidably diminishes U.S. influence in Costa Rica and affects the level of cooperation in the areas of counternarcotics, counterterrorism, and trade.

¶7. (C) The Pacheco Administration, which took office in May 2002, has been characterized by passivity, inactivity, and, stated bluntly, a leadership void. Admittedly, the president has had to deal with a fragmented legislature where often a small minority can prevent action. Further complicating governance in Costa Rica are a supreme court and autonomous regulatory bodies that insert themselves in matters we normally think of as the prerogative of the executive branch, such as whether or not to support the U.S.-led coalition in Iraq. The next general elections in Costa Rica are scheduled for February 5, 2006, and we expect far more vigorous leadership if former president and current front-runner Oscar Arias is elected. Arias is much more committed to free-market policies and CAFTA-DR than is Pacheco, but with respect to some international issues, such as the use of military force and levels of economic assistance from rich to poor countries, Arias will likely be at odds with the United States.

CAFTA-DR RATIFICATION) A LONG ROW TO HOE

¶8. (U) Costa Rica is the only CAFTA-DR signatory country not to have already ratified the agreement. Fourteen months after signing CAFTA-DR and after much public debate over whether or not the agreement would benefit the poor, President Pacheco on October 21, 2005 finally sent the agreement to the Assembly to start the relatively long ratification process. Currently, the Assembly's International Relations and Trade Committee is studying CAFTA-DR and holding hearings with various groups about the agreement.

¶9. (U) Due to the legislative recess from December 23, 2005 through February 13, 2006 for the holidays and the national elections, completion of the Committee's work is expected no sooner than the end of April 2006, just before the new deputies take office on May 1, 2006. (Note: The new Administration takes office on May 8, 2006. End Note.) After the Committee has sent its findings to the Assembly floor, two separate votes by the Assembly are required to pass the agreement, between which the Constitutional Court will review CAFTA-DR for any legal or procedural issues. The total ratification process will take at least six months and most likely longer.

¶10. (SBU) Unlike the path taken by the U.S. Congress, the Assembly will approve CAFTA-DR separately from the legislation that will actually implement the agreement. To date, the implementing legislation has not been sent to the Assembly, and passing these bills could be as difficult as passing CAFTA-DR. These bills should effect the gradual phased opening of the telecommunications and insurance markets to competition) markets that are currently legally monopolized by the state-owned Costa Rican Institutes of Electricity (ICE) and Insurance (INS), respectively.

¶11. (SBU) Public knowledge of and support for CAFTA-DR has grown over the last year with an October 2005 CID/Gallup poll revealing that 64 percent of the respondents were at least &somewhat8 in favor of the agreement. Those responding that they were &somewhat8 or &very much8 opposed constituted 26 percent. Sixty-one percent of those who knew something about the agreement responded that they thought CAFTA-DR would benefit Costa Rica.

TRADE OVERVIEW

¶13. (U) Due to its small size, geographic location, and limited natural resources, Costa Rica relies heavily on foreign trade and investment. The United States provides 46 percent of Costa Rica's imports and consumes 44 percent of Costa Rican exports. According to the U.S. Census Bureau, through September 2005, two-way trade between the U.S. and Costa Rica amounted to approximately USD 5.1 billion. Total trade for 2004 was USD 6.6 billion, a 12-percent increase from 2003. Costa Rica accounts for one-third of U.S. trade with the five Central American CAFTA-DR countries. Over the last twenty years, Costa Rica has taken steps to diversify its economy and, as a result, has become less dependent on the traditional agricultural crops for generating revenue. In general Costa Rica has integrated itself more into the global economy; growing imports and exports are proof of that.

¶14. (U) Costa Rica exported USD 2.8 billion worth of goods to the U.S. in 2004. Traditional agricultural products such as bananas and coffee dominated exports 20 years ago. Now integrated circuits and medical devices are the top exports to the U.S. from Costa Rica. With regard to revenue generation, tourism is number one in Costa Rica. Approximately 1.6 million visitors came to Costa Rica in 2004, more than 600,000 of them from the U.S., generating USD 1.4 billion. Through the first half of this year, tourism income is up 17 percent as compared to the same period last year. Tourism also plays a special role in the Costa Rican economy by providing approximately 300,000 direct and indirect jobs, a large portion outside the San Jose area.

¶15. (U) Costa Rica imported USD 3.8 billion worth of U.S. goods from the U.S. in 2004. Top imported items included semiconductors and textile materials. The U.S. is a major supplier of corn, wheat, rice, soybeans, and consumer foods to Costa Rica. Costa Rica is a solid market for U.S. agricultural exports, but the U.S. currently imports from Costa Rica more than three times what it exports to Costa Rica.

¶16. (U) The total flow of foreign direct investment (FDI) into Costa Rica was USD 596 million in 2004, 66 percent of which came from the U.S. The Central Bank of Costa Rica estimates that FDI will fall to USD 540 million in 2005 based on a declining investment climate. FDI is concentrated in the industrial manufacturing sector which attracted USD 437 million in 2004, followed by the tourism and services sectors which attracted USD 51 and USD 37 million, respectively.

LOW REAL GROWTH, HIGH INFLATION, LARGE DEBT

¶17. (U) Global economic changes affect Costa Rica's economy. For instance, the increase in gasoline prices in 2005 hit Costa Ricans especially hard since they have no domestic oil production capabilities. Costa Rica's economy is also affected by operations of large multi-national companies that have manufacturing and service operations in Costa Rica. Intel has a large operation in Costa Rica and its growth or lack thereof has a noticeable effect on the economic situation. In 2003 when Intel's exports increased 32 percent, the Costa Rican economy grew 5.6 percent. In 2004, Intel's exports dropped and growth was 4.2 percent. (Note: The growth could have been lower but was helped by continued strong growth in non-traditional agricultural exports that year. End Note) GDP growth for 2005 is expected to be approximately 4.1 percent. Inflation remains a significant macroeconomic challenge, and at 14.2 percent over the last twelve months it is at its highest level in eight years and one of the highest rates in Latin America. The higher-than-expected inflation and slower-than-expected growth in exports led the Central Bank to increase the rate of colon (the local currency) devaluation against the dollar in July 2005.

¶18. (U) The fiscal deficit is one of Costa Rica's most serious macroeconomic problems. More than 90 percent of the GOCR's income is used to pay government salaries, pensions, social benefits, and interest payments on the national debt. The central government's fiscal deficit is projected to be about 2.8 percent of GDP for 2005. This compares to 2.5 and 3.0 percent of GDP for 2004 and 2005, respectively. Fiscal reform legislation, one of the Pacheco Administration's primary goals, has languished in the legislature for over three years. This proposal is mainly a tax increase and does not contemplate spending cuts. The President's bill has been blocked by the minority Libertarian Movement (ML) Party in the Assembly.

¶19. (U) At the end of 2004, Costa Rica's public sector debt topped USD 10.5 billion. The central government's deficit is largely financed by government borrowing and the surpluses generated by some state-owned monopolies (which include telecommunications, electrical power, insurance, and petroleum distribution). In late 2004, the GOCR, unable to

attract investors on the open market, resorted to forcing state-owned service providers to take on government debt to allow the GOCR to meet its end-of-year obligations.
LANGDALE